STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: AQUILA, INC., d/b/a AQUILA NETWORKS	DOCKET NO. SPU-03-7

ORDER RESCHEDULING HEARING AND REQUIRING RESPONSES TO BOARD QUESTIONS

(Issued July 3, 2003)

On May 21, 2003, the Utilities Board (Board) issued an order denying a request for expedited waiver filed by Aquila, Inc., d/b/a Aquila Networks (Aquila), and establishing a procedural schedule for consideration of a proposal for reorganization. On June 13, 2003, the Board issued an order rescheduling the hearing in this docket to August 19, 2003, and indicating the Board would be issuing an order with questions for the parties after Aquila filed rebuttal testimony.

Since the order issued June 13, 2003, rescheduling the hearing in this docket, the Board has discovered a conflict with other matters. To remove that scheduling conflict and to allow the parties some additional time to respond to the Board questions in this order, the Board is rescheduling the hearing to August 26, 2003. The date for filing briefs will be adjusted accordingly.

Aquila filed rebuttal testimony on June 17, 2003, and the Board is issuing this order with questions for the parties based upon the prefiled testimony and application. The questions for the parties are set out below. The parties should respond to the questions in prefiled testimony format from a witness who is prepared to respond to additional questions at the hearing. Even if a question appears to be addressed to one party, the other party may respond to the question.

BOARD QUESTIONS

1. What protections would a holding company corporate structure provide for Aquila's Iowa regulated utility ratepayers that are not available under Aquila's current corporate structure?

2. Can Aquila achieve its goal of only operating regulated utility businesses without the pledge of Iowa assets requested in this docket?

3. The Board has experienced twice the number of calls from Aquila customers in 2003 compared to 2002 regarding disconnections and billing problems. Has Aquila experienced the same increase in customer calls? Provide any reports or the results of any studies or investigations concerning customer service or complaints Aquila has prepared or conducted since June 2002.

4. Mr. Epson, in his rebuttal testimony, states that no other plan exists for funding Aquila's day-to-day working capital. How will Aquila fund day-to-day working capital if the Board and other state regulatory agencies disapprove the reorganization proposal?

5. Please provide citations to court decisions or other documents that support the statement that Aquila "would be free to use its cash assets to satisfy the

claims of its Iowa utility customers" in a bankruptcy proceeding. Provide citations to court decisions or other documents that are contrary to this statement.

6. Assuming hypothetically that a public utility were to file for bankruptcy after seeking to pledge its Iowa assets, would Iowa customers be better off if the Board allowed Iowa assets to be pledged and then the utility files for bankruptcy, or if the Board disapproves the pledge of Iowa assets and the utility files for bankruptcy?

7. In Ms. Armstrong's rebuttal testimony on Exhibit BAA-1 page 1, under Gas Supply, both December and January are used in calculating Iowa's Estimated Working Capital. Only the January data are used in calculating Iowa's Estimated Working Capital for Storage and Pipeline Capacity.

a. Why is the December data included for Gas Supply and not for Storage and Pipeline Capacity?

b. Are the amounts used for gas purchases in the exhibit sensitivity tested for colder than normal weather or significantly increased gas prices?

c. Does the Cash Receipts amount on the exhibit include more than one month of receipts?

d. If the Cash Receipts are for only one month, why are two months of gas supply applied to it?

8. On Exhibit BAA-1, Supplemental Schedule 2, Iowa's portion of cash receipts is calculated at 12.3 percent.

a. Explain how the 12.3 percent is calculated.

b. Do the receipts/revenues listed on Supplemental Schedule 2 include electric receipts/revenues?

c. Under Cash Receipts for Jan 03 on Supplemental Schedule 2, abbreviations such as MGD are used. Provide a full description for each of the abbreviations.

d. Why is the total for PND Revenues by State Jan Rev on Supplemental Schedule 2 different than the PND amount under Cash Receipts for Jan 03 on Supplemental Schedule 2?

9. Are all of the numbers on Exhibit BAA-1, page1, Supplemental Schedule 1, pages 1-2, and Supplemental Schedule 2 projected numbers? Do any actual numbers exist for this information? Also, provide the year to which the numbers are applicable.

10. Explain why the amount shown for Cash Receipts for Jan 03 Exhibit BAA-1, Supplemental Schedule 2, is a different amount than Cash Receipts on Exhibit BAA-1, page 1.

11. In the last paragraph of the last page of Confidential Exhibit __(RD-3), Aquila discusses information for U.S. Networks. Provide corresponding information for Iowa only for the same period.

12. Does Consumer Advocate agree or disagree with Ms. Armstrong's rebuttal testimony, page 4, line 13, where Ms. Armstrong states that it is not appropriate to employ the same methodology used to determine the working capital

component of rate base in the context of a rate case to determine the peak working capital needs for financing purposes. Explain.

13. Exhibit RD-8, page 6, states that “Generally substantive consolidation is ordered in cases where the assets and liabilities of the debtors are so completely entangled that it would be next to impossible to ascertain each debtor’s separate assets and liabilities, or where the businesses and affairs of the affiliated debtors were organized operated and presented to creditors as a single integrated unit.” Do you believe that substantive consolidation should be ordered for Aquila because of the way it is currently structured?

14. Provide the history of Aquila’s debt rating over the last 4 years.

15. On pages 3-4 of Mr. Empson’s direct testimony, there is a reference to a Kansas Corporation Report, Docket No. 02-UTCG-701-GIG, and to a Missouri Public Service Commission Staff Report on Aquila. Provide copies of both reports.

16. Does Consumer Advocate agree with Mr. Empson’s statements on page 2 of his rebuttal testimony where he provides a number of arguments in support of his belief that reliance on the Portland General structure is misplaced? Explain.

17. Does Consumer Advocate have any specific concerns with respect to Aquila's current service quality?

18. In his direct testimony, page 2, lines 20-21, Mr. Vitale states, “As one of the conditions, Aquila agreed to make a reasonable effort to gain state regulatory approval to secure the three-year loan with additional utility assets.” Specify the

provisions (number and page) in Aquila Exhibit B (Form 10-K) or other filed materials that identify the exact legal condition to which Aquila agreed.

19. As filed in Aquila's Form 10-K (p. 228 of Exhibit B), the U.S. $430,000,000 Credit Agreement states: "The proceeds of the Loans are to be used by the Borrower, first, to repay in full the Existing Credit Agreements and certain other indebtedness and, thereafter, to provide working capital and for other general corporate purposes of the Borrower."

a. According to the Credit Agreement's definition, the "Existing Credit Agreements" include the (i) the Citibank 364-Day Revolving credit Agreement and (ii) the Citibank 3-Year Revolving Credit Agreement. How much is owed on each of these Credit Agreements?

b. How much was the "certain other indebtedness" that was also required to be first repaid in full? To whom was this owed?

20. As filed in Aquila's Form 10-K (pp. 274 -84 of Exhibit B), Article 6 of the $430 million Credit Agreement imposes a number of negative covenants upon Aquila. For example, Section 6.2 states the borrower shall not "convey, sell, lease, assign, transfer or otherwise dispose of . . . mortgaged property under the first Mortgage Indenture." Section 6.7 also articulates limitations on sale of assets.

a. Do these sections or anything else in the Credit Agreement currently restrict Aquila's ability to sell its Iowa utility property? If so, explain with explicit references.

b. Briefly explain the procedure that Aquila would have to go through in order to sell its Iowa utility property at this time.

c. If the Iowa assets were already pledged as collateral under company's proposal, what additional steps and procedures would Aquila have to go through in order to sell the Iowa utility property?

21. According to page 33 of Mr. Vitale's workpapers, Arthur Andersen was Aquila's auditor. Is Aquila currently subject to, or has it been subject to in the last three years, any SEC or other federal government investigation due to accounting, market manipulation, or other irregularities? If the answer is yes, please explain, including a description of the current status of any such investigation.

22. Provide an overview summary of docket activity in the other four states for which Aquila has requested authority to pledge its utility assets. This should include docket numbers and basic procedural schedules noting when testimony is filed, hearing dates, briefing dates, and decision date or procedural deadline for decision.

23. The Bankruptcy Equivalent Analysis, February 6, 2003, presentation to the Board of Directors of Aquila, Inc. (p. 21 of Consumer Advocate's workpapers), gives an estimated equity value for Aquila, Inc.

a. That value appears to be the value of Aquila assuming it goes through bankruptcy and reorganization. Is this correct? If not, what is it? Explain.

b. That page also lists “estimated reorganized value” and “estimated total claims.” Is the difference an appropriate current estimate of the equity value of Aquila assuming bankruptcy is avoided? If not, explain.

24. Exhibit__(RD-2) gives the relationship between EBITDA valuation and debt capacity while Mr. Dobson’s direct testimony (page16, lines 23-24, and page 11, lines 5-7) gives the relationship between debt capacity and supported loan amount.

a. These two separate relationships appear to be used in conjunction to determine how much EBITDA valuation is needed to support a given loan. If this is not a correct understanding of the exhibit, please explain.

b. Identify the exact provisions of the credit agreement or other filed documents that specifically define these numerical relationships.

25. In Mr. Dobson’s direct testimony, page 10, lines 17-19, he states that the Canadian investment supports the $180 million portion of the loan over and above $250 million working capital needs and to fill the gap on the required collateral for working capital requirement. Given the level of debt capacity for Michigan and Nebraska as shown in Exhibit __(RD-2), how much additional debt capacity is needed to cover all of the $250 million working capital needs?

26. In direct testimony, page 11, Mr. Dobson states, “if the Canadian assets are sold, 100 percent of the net proceeds must be used to repay the term loan until the remaining utility collateral value equals or exceeds 1.67 times the then outstanding term loan balance.”

a. If that happens and the remaining utility collateral is limited to Michigan and Nebraska, what outstanding term loan balance could be supported?

b. If Aquila sells its Canadian utilities for net-after-tax proceeds as expected on page 8 of Exhibit___RD-1, how much of these proceeds would go to repay remaining Canadian debt? Assuming utility collateral is limited just to Michigan and Nebraska, how much would go to buy-down the $430 million term note? And how much would be left over to support liquidity? Explain.

27. Exhibit__RD-2 uses EBITDA multiples that vary in the calculation of values of debt capacity. What is considered an industry benchmark level (naming the source) for EBITDA multiples at this time? Also explain why the multiples used vary from state to state?

28. On page 11, lines 14-15, of his direct testimony, Mr. Dobson states, “the borrowing rate under the facility drops 75 basis points if Aquila adds additional utility operations as collateral.” Taking into account Michigan and Nebraska’s pledged assets, what is the minimum amount of additional pledged assets needed to trigger the 75-basis-point drop. Identify the provisions in the credit agreement that address this requirement.

29. In rebuttal testimony, page 4, lines 12-14, Mr. Empson states, “Once the restructuring plan is complete, adoption of a corporate holding structure will be both unnecessary and inappropriate because Aquila will own only regulated utilities.”

a. When is it expected that the restructuring plan will be complete such that Aquila will "own only regulated utilities?" Reconcile the answer to page 16 of Confidential Exhibit__(RD-1).

b. What percentage of the planned "only regulated utilities" is expected to be in the United States? If not 100 percent, where will the rest likely be?

c. Once Aquila transitions to a totally-regulated utility, what requirements should be imposed upon Aquila to insulate the regulated utility operations from the risks associated with subsequent non-regulated business activities?

30. Does Consumer Advocate agree with Mr. Empson's statements on lines 12 to 14, page 4, of his rebuttal testimony where he states, "Once the restructuring plan is complete, adoption of a corporate holding structure will be both unnecessary and inappropriate because Aquila will own only regulated utilities." Explain.

31. The Application, page 3, notes that Aquila's workforce has been reduced by more than 1500 employees.

a. How many of these 1500 employees are Iowa-based employees?

b. Are there plans to make further employment reductions in Iowa as the Debt Reduction and Restructuring Plan is implemented? If the answer is yes, provide the projected employee counts by job function.

c. What is the potential that these and planned future reductions will impact future service quality? Explain why or why not.

32. In its Application, page 12, Aquila states, "Whether it is connecting new service, responding to complaints, billing accuracy, or emergency service, the company has maintained and in most cases improved its performance the past year." Provide Aquila's analysis and data to support this assertion. Also compare the most recent year to the past three years.

33. Provide any Credit Rating Reports on Aquila issued since Aquila's February 28, 2003, filing under 199 IAC 32.3(4), entitled "Annual Summary of Foreign Acquisitions and Credit Rating Reports."

34. In his rebuttal testimony, page 3, lines 10-13, Mr. Mann states that under Section 507 of the Bankruptcy Code, deposits of customers are granted a priority to the extent of $2,100 per individual customer.

a. Does that mean a customer deposit of $2,100 or less is secure under all circumstances? If not, explain.

b. Is the deposit available for refund to the customer in a time span typical for a non-bankruptcy status?

35. In his rebuttal testimony, page 6, lines 8-11, Mr. Mann states, “even if a pledge of Iowa assets did not occur before a bankruptcy filing, in the event of a bankruptcy, the Iowa assets would in all likelihood be pledged to the DIP lenders.”

a. Do you know of situations where the utility assets were not so pledged? What circumstances or reasons have prevailed or might exist that meant the utility assets were not pledged to the DIP lenders?

b. In case of bankruptcy, how does the pledging of utility assets to DIP lenders differ from the pledging of utility assets as requested in this docket? Discuss the implications of that difference.

36. In his rebuttal testimony, page 6, lines 17-21, Mr. Mann states, “the federal bankruptcy court has the power to approve the debtor’s plan of reorganization and many other aspects of the debtor’s business operations, without regard for the views and opinions of the state regulatory commission or the need for such commission’s approval.”

a. Can the bankruptcy judge overrule any and all Board decisions? Explain.

b. Is it Mr. Mann’s opinion that the authority of the bankruptcy judge always prevails over the jurisdictional authority of state commissions? If not, explain the situations and rationale where authority is shared or where the bankruptcy judge may defer to state commissions.

37. The January 9, 2003, Rating Action of Moody's [filed by Aquila February 28, 2003, in compliance with 199 IAC 32.3(4)] notes, "Further downgrade of the company's rating could lead to additional collateral calls." Is this still a problem after the new $430 million term note? If yes, what additional calls would result with such a downgrade? Would Aquila's Debt Reduction and Restructuring Plan have to be altered in such a contingency? If so, in what way?

38. The February 24, 2003, Fitch downgrade [filed as Exhibit 2-J by Aquila with the Board on February 28, 2003 in compliance with 199 IAC 32.3(4)] states that the FERC's "order on February 20, 2003 (regarding Westar Energy's financing request), imposes new rules on debt authorization that may further complicate the pledge of utility assets in states that do not regulate this directly." According to the FERC News Release (Docket No. ES02-51-000), the new conditions announced by FERC are:

> (1) Public utilities seeking authorization to issue debt backed by a utility asset must use the proceeds of the debt for utility purposes only.
>
> (2) If any utility assets that secure debt issuances are "spun off," the debt must follow the asset and also be "spun off."
>
> (3) If any of the proceeds from unsecured debt are used for non-utility purposes, the debt must follow the non-utility assets. If the non-utility assets are "spun off," then a proportionate share of the debt must follow the "spun-off" non-utility asset.

(4) If utility assets financed by unsecured debt are “spun off” to another entity, then a proportionate share of the debt must also be “spun off.”

a. Is the $430 million term note consistent with these standards? Explain, especially in regard to the first standard.

b. Will Aquila’s Debt Reduction and Restructuring Plan, if implemented as planned, be consistent with these new standards? Explain.

39. According to a June 2003 report by FitchRatings, entitled “U.S. Power & Gas 2003 Summer Briefing,” Aquila has $754 million of secured and structurally senior debt, $3,025 million total unsecured debt and pre-pays, but a total stressed enterprise value (before costs of bankruptcy) of only $2,640 million.

a. Does this comport with Aquila’s own appraisal of its financial situation? Explain.

b. What are the implications of Fitch’s perspective, especially as it might impact Aquila’s restructuring plans?

40. In his direct testimony, page 9, lines 3-5, Mr. Vitale states that Iowa’s utility operations can be protected as effectively as Portland General’s customers.

a. Identify the various steps taken and provisions adopted in the Portland General case in providing that protection and explain which provisions appear the most useful and why.

b. Do any of those provisions have applicability to the utility division of Aquila as currently structured? If so, which?

c. Which provisions could this Board impose and upon what specific authority?

41. In his rebuttal testimony, page 6, lines 6-11, Mr. Mann states, "even if a pledge of Iowa assets did not occur before a bankruptcy filing, in the event of a bankruptcy, the Iowa assets would in all likelihood be pledged to the DIP lenders."

a. Does Consumer Advocate agree with this conclusion? If not, explain.

b. If the conclusion is correct, is there any reason to withhold the pledging now if doing so would help to reduce the probability of bankruptcy? Explain.

42. Does Consumer Advocate agree with Mr. Mann in his rebuttal testimony, page 7, lines 13-15, where he states, "Aquila's Iowa customers will be protected to the same extent in a bankruptcy of Aquila, regardless whether the Iowa assets are pledged now or not?" Explain.

43. On page 13, lines 4-9, of Mr. Dobson's direct testimony, he states, "when the term loan expires, it would be our intent to continue with a working capital debt instrument secured by utility assets." Would or should any pledging of the assets for a subsequent loan require another application before this Board? Should

any approval of pledging of utility assets be restricted just to the current term loan? Explain.

IT IS THEREFORE ORDERED:

1. The hearing scheduled for August 19, 2003, is rescheduled for 9 a.m. on August 26, 2003. The purpose of the hearing is to receive testimony and cross-examination of all testimony. The hearing shall be held in the Utilities Board hearing room, 350 Maple Street, Des Moines, Iowa. The parties shall appear one-half hour prior to the time of the hearing for the purpose of marking exhibits. Persons with disabilities requiring assistive services or devices to observe or participate should contact the Utilities Board at (515) 281-5256 in advance of the scheduled date to request that appropriate arrangements be made.

2. The parties may file simultaneous initial briefs on or before September 5, 2003.

3. The parties may file simultaneous reply briefs on or before September 12, 2003.

4. In the absence of objection, all underlying workpapers shall become a part of the evidentiary record of these proceedings at the time the related testimony and exhibits are entered into the record.

5. Prefiled testimony with responses to the Board's questions set forth in the body of this order shall be filed on or before July 18, 2003.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 3rd day of July, 2003.